



# **ROYAL BANK OF CANADA**

## **OUR APPROACH TO COMPENSATION**

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## OUR APPROACH TO COMPENSATION

The Board of Directors of RBC has long been at the forefront of compensation best practices and believes that shareholders should have the opportunity to understand fully the objectives, philosophy and principles of executive compensation at RBC. The board paid particular attention over the past year to governance and controls in place for executive compensation. Our Human Resources Committee (the Committee), which is comprised solely of independent directors, advises the board on compensation principles and policies and reviews incentive compensation programs across the organization. The Committee recognizes that independence from management is fundamental to its effectiveness and consults with an independent external compensation expert. The members of the Committee have significant experience in executive compensation and risk management through experience as senior leaders of complex organizations.

### Compensation framework: *Why we pay what we do*

Our compensation philosophy recognizes that a highly qualified global workforce is critical to our continued success. Our compensation programs are designed to attract and retain the talent needed in a highly competitive global marketplace. These programs are aligned with performance goals that motivate executives to achieve strategic goals prudently and within acceptable risk tolerances, driving superior financial performance and generating long-term shareholder value that is sustainable.

Our approach to compensation is designed around four key principles:

- **Compensation aligns with shareholder interests:** payouts from incentive programs vary based on the Bank's absolute and relative performance.
- **Compensation aligns with sound risk management principles:** compensation programs and practices align with the enterprise-wide risk management framework to ensure there is a balance between risk and reward.
- **RBC pays for performance:** a large proportion of executive pay is *at-risk*, with upside potential to reward outstanding performance and downside risk if results fall short of objectives.
- **Compensation enables RBC to attract and retain talent:** target compensation is benchmarked against peer group financial institutions to ensure it is competitive in the markets where we compete for talent. The equity incentive programs, including their forfeiture provisions, also encourage executives to remain with RBC.

### Components of compensation

Our compensation programs include base salary and performance-based incentive awards:

- **Base salary:** reviewed annually; adjusted with changes in roles or expertise or results of benchmarking of equivalent roles at peer companies.

#### Executive Program

- **Annual variable short-term incentive (STI):** rewards executives for the fiscal year performance; if the Return of Equity (ROE) performance threshold has been met, STI rewards performance assessed against individual performance goals, as well as business segment and overall RBC performance based on Net Income after Tax (NIAT).
- **Mid and long-term incentives:**
  - ⇒ Performance deferred share unit program: unit grants that vest after three years and whose value could increase or decrease depending on the Bank's total shareholder return (TSR) performance relative to our peer group. There would be no payout if pre-defined performance thresholds are not met.
  - ⇒ RBC share unit program: restricted share unit grants that vest after three years.
  - ⇒ Stock option program: granted to senior executives to encourage focus on enhancing shareholder value over the longer term; half of the granted options vest at the end of the third year after grant and half at the end of the fourth year.

## **RBC Capital Markets Program**

- **RBC Capital Markets compensation program:** applies to the majority of managing directors in RBC Capital Markets, including senior leaders.
  - ⇒ **RBC Capital Markets bonus pool:** based on earnings before taxes as well as an adjustment to reflect overall RBC performance. Capital Markets earnings before taxes include capital charges and risk-related adjustments such as provisions for credit losses, liquidity reserves, trading losses and mark-to-market adjustments. Bonus awards are paid in both cash & deferred equity.
  - ⇒ **RBC Capital Markets unit award program:** represents the deferred component of the annual bonus award which vests over three years.

### **Key facts about executive compensation at RBC**

- Senior executives, who have more influence over corporate performance, have a much greater portion of their compensation at risk based on both individual and business performance:
  - ⇒ For Named Executive Officers, whose pay is disclosed in the proxy circular, the proportion of 2009 total direct compensation *at-risk* ranges from 85 - 98%; and
  - ⇒ A significant portion of *at-risk* pay is deferred as equity incentive awards, which better aligns compensation with the risk horizon, focusing executives on generating long-term and sustainable value for shareholders.
- Share ownership requirements align the interests of executives and shareholders. The CEO must maintain minimum share ownership equal to 8 times base salary and Mr. Nixon's total RBC share holdings at 2009 fiscal year-end exceeded 38 times his salary. Most other members of our senior management team (the Group Executive or GE) must hold 6 times average base salary, with the Co-Group Heads of RBC Capital Markets required to hold 2 times average salary plus bonus. These requirements extend two years into retirement for the CEO and one year for other GE members.
- In the event of fraud or misconduct, including failure to follow internal policies and procedures, RBC can cancel unvested mid and long-term incentive awards and recoup incentive awards that have already been paid or vested.
- We do not have employment contracts with any member of GE, including the CEO, and in the event of termination for cause, a severance payment is not guaranteed.

### **Incentive compensation aligns with prudent risk management**

Sound risk management principles are a key contributor to our success. They are reflected throughout the design and governance of our compensation programs to ensure alignment with the Principles for Sound Compensation Practices (Implementation Standards) issued in 2009 by the Financial Stability Board. RBC compensation practices and processes that are designed to address excessive risk-taking include:

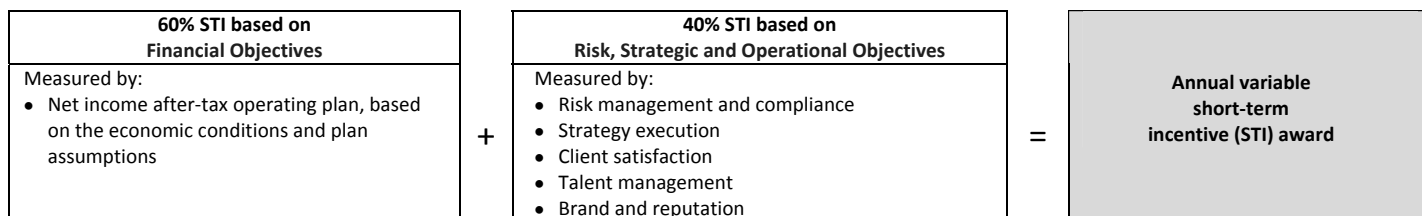
- Performance-based incentive payout pools for executives and Capital Markets employees are primarily based on earnings, rather than revenues.
- A minimum return to shareholders is required before payouts are made from the executive performance-based incentive program.
- Individual incentive bonuses are based on an assessment of both financial and non-financial performance, including adherence to risk and compliance policies and procedures.

In 2009, we made a number of changes to our compensation program design and compensation governance practices to strengthen compensation risk management. Changes include:

- Expansion of our forfeiture and clawback provisions for executives of the Bank and employees of RBC Capital Markets to allow RBC to recoup incentive awards that have already been paid, in addition to cancelling unvested performance-based incentive awards for individuals who engage in conduct detrimental to RBC.
- Increased deferrals for Capital Markets and vesting schedules were changed from 33% over each of the three years to 25% at the end of the first year, 25% at the end of the second year and 50% at the end of the third year.
- The Co-Group Heads of RBC Capital Markets will receive at least 66% of their bonus awards in deferred compensation; other senior leaders in Capital Markets must defer at least 45% of their bonus awards.
- The stock option program vesting schedule was adjusted whereby 50% of options will vest three years after grant date and the remaining 50% will vest four years after grant date. Options previously vested on the basis of 25% annually, beginning one year after the grant date.
- Established the Compensation Risk Management Oversight Committee to ensure alignment with sound risk management. This senior management committee comprised of the Chief Risk Officer, Chief Human Resources Officer, and the Chief Administrative Officer and Chief Financial Officer, reviews and monitors compensation program design and payouts of incentive programs.
- The Human Resources Committee meets formally with the Chief Risk Officer to ensure incentive compensation aligns with sound risk management principles and incentive awards are symmetric with risk outcomes.

## Key Changes to 2010 Compensation

To reduce the complexity of the STI program for senior executives, on the Committee's recommendation, the board approved design changes which come into effect in 2010. The financial objectives will account for 60% of performance and the risk, strategic and operational objectives will account for 40%. Target award levels are established and the incentive funding cap will be 2.5 times target.

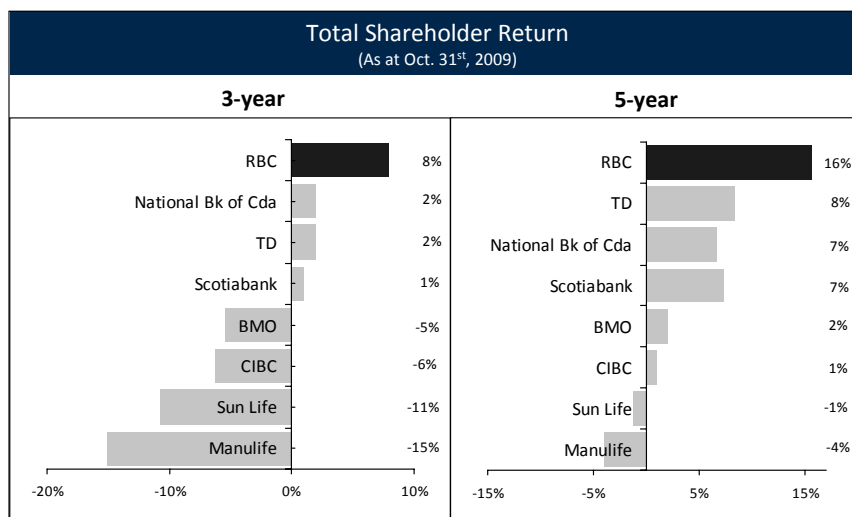


## Determining 2009 Compensation

While the recessionary environment and difficult market conditions of 2009 contributed to a challenging year, the Bank's performance demonstrated the competitive advantage of its diverse mix of businesses, its comprehensive approach to risk management, an effective leadership team and an engaged workforce. At the end of 2009, RBC stands apart as a globally significant, strong and stable financial institution, with businesses that span personal and commercial banking, wealth management services, insurance, corporate and investment banking and transaction processing services. We have improved our Tier I capital ratio, sharpened our focus on cost management, improved our market share in many businesses and attracted and retained talented people to help us build our future success. Within our Canadian peer group, we are the largest in terms of total assets, net income, market capitalization and the number of full-time employees and second largest in terms of revenue. Three and five-year TSR of 8% and 16%, respectively, ranked RBC in the top quartile of our peer group.

| <b>Compensation Peer Group <sup>(1)</sup></b><br>(CAD\$ billion) |                       |                |              |
|--|-----------------------|----------------|--------------|
| Company  | Market Capitalization | Assets         | Net Income   |
| <b>RBC</b>   | <b>77,546</b>         | <b>654,989</b> | <b>3,858</b> |
| The Toronto-Dominion Bank  | 52,785                | 557,219        | 3,120        |
| The Bank of Nova Scotia  | 46,191                | 496,516        | 3,547        |
| Manulife Financial Corporation                                   | 32,766                | 211,025        | 497          |
| Bank of Montreal   | 27,578                | 388,458        | 1,787        |
| Canadian Imperial Bank of Commerce                               | 23,728                | 335,944        | 1,174        |
| Sun Life Financial Inc.  | 16,786                | 119,833        | 857          |
| National Bank of Canada  | 9,078                 | 132,138        | 854          |

(1) Assets and Net Income as at Oct. 31, 2009 for Banks; Dec. 31, 2008 for Insurance companies. Market capitalization for all companies as at Oct. 31, 2009.



To achieve organizational success, our compensation must remain competitive in the markets and businesses where we operate and reflect our size, complexity and absolute and relative performance. We accordingly remain committed to our pay-for-performance philosophy.

In assessing performance and determining compensation of the CEO and other members of GE, the Committee considers a number of factors, including:

- performance against the Bank's short and medium-term financial, risk, strategic and operational objectives.
- for business heads, in addition to RBC financial performance, business segment performance against short and medium-term financial, risk, strategic and operational objectives.
- performance of RBC relative to peer group performance.
- an executive's potential for future contribution to creating long-term shareholder value.
- market competitiveness of compensation relative to peer group, giving consideration to our relative size and complexity.

The board has discretion to adjust compensation downwards or upwards based on the following secondary measures and the business environment in which the results were achieved:

- absolute and relative financial performance, including ROE, Earnings per Share (EPS), TSR, as well as operating leverage and cost management initiatives;
- risk-adjusted performance (economic profit);
- client satisfaction and market share;
- employee engagement; and
- extraordinary, unusual or non-recurring items.

In determining appropriate compensation for the CEO, the Committee reviews peer group data and evaluates his performance against his objectives. The Committee conducts stress-testing to determine pay-outs of performance-based incentives under different scenarios of RBC performance as well as back-testing on the current value of his performance-based incentive awards to determine whether there has been an extraordinary compensation outcome unrelated to performance. It also analyzes from a shareholder's perspective the "value for performance" of the CEO's compensation by using an index that compares CEO performance-based incentive awards to TSR, ROE, and EPS growth among the benchmark peer group.

The CEO's leadership and focus in 2009 on risk management, strategy execution and client satisfaction were assessed as key to accelerating performance of RBC ahead of national and global competitors during one of the industry's most difficult periods. Details of the performance of RBC in 2009 are available in our Annual Report at:

[www.rbc.com/investorrelations/pdf/ar\\_2009\\_e.pdf](http://www.rbc.com/investorrelations/pdf/ar_2009_e.pdf). Based on strong performance achieved in a challenging environment, on the Committee's recommendation the board exercised its discretion to exclude the goodwill impairment charge from the STI calculation, resulting in an adjusted NIAT of \$4.858 billion, which translated into an STI *business performance multiplier* of 70% for the CEO and other GE members in corporate support roles. The Committee evaluated 2009 results against Mr. Nixon's financial objectives (50% weighting) and his risk, strategic and operational objectives (50% weighting). With respect to the financial results, the Committee gave particular consideration to reported net income, cash earnings, operating leverage, top quartile three and five-year TSR, a strong Tier 1 capital ratio and strong earnings growth in certain of the Bank's capital markets businesses. Based on these results, the Committee established Mr. Nixon's *individual performance multiplier* at 135%.

The Committee applied the STI formula, multiplying Mr. Nixon's STI target of \$2,100,000 by the RBC *business performance multiplier* of 70% (determined by Net Income after Tax) and his *individual performance multiplier* of 135%. The Committee recommended an STI award of \$2,000,000, which was approved by the board. To further align Mr. Nixon's compensation to the Bank's mid-term performance and reinforce the focus on generating long-term value for shareholders, the STI of \$2,000,000 was awarded in the form of restricted share units under the RBC share unit program. The award will vest three years from the grant date.

The Committee reviewed Mr. Nixon's target for mid and long-term incentive compensation in light of his sustained performance over his successful tenure as CEO and the Bank's size and scope relative to the peer group. It recommended that his mid and long-term incentive awards should be above the peer group median. The Committee considered the absolute and relative financial performance of RBC, including its top quartile three and five-year TSR and capital strength, which positions RBC to extend its market leadership in Canada and abroad. On this basis, the Committee recommended and the Board approved a mid and long-term incentive award of \$7,000,000, split equally between three year performance deferred share units (\$3,500,000) and stock options (\$3,500,000).

In 2009, 100% of the CEO's performance-based incentive pay was deferred through equity-based mid and long-term incentive awards.

The Committee also reviewed the market competitiveness and retention value of Mr. Nixon's pension arrangements and determined it was appropriate to position his pension arrangement above the median of the peer group. The Board reviewed and approved the new arrangement, which is a fixed amount pension whereby Mr. Nixon's annual pension benefit will increase by \$100,000 for each additional year of service, and is capped at a maximum annual pension of \$2,000,000 beginning in 2017 at age 60. Under the previous arrangement his maximum annual pension benefit was \$1,456,000 beginning in 2012 at age 55. Mercer (Canada) Ltd., actuaries for RBC, calculated the one-time increase in the accrued obligation of Mr. Nixon's new arrangement to be \$920,000, an item that will not recur in future years.

At RBC, compensation is designed to reward executives for achieving corporate goals and to align the interests of executives and shareholders in creating long-term value. The Board of Directors closely monitors developments in executive compensation, its disclosure and governance, and our practices and policies will continue to evolve with best practices and regulatory change. Executive compensation at RBC is discussed in greater detail in our 2010 proxy circular, which is available at: [www.rbc.com/governance](http://www.rbc.com/governance).